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FISCAL IMPACT REPORT

ORIGINAL DATE 2/13/18

SPONSOR HRC LAST UPDATED _____ HB 324/HRCS

SHORT TITLE Data Center Taxes SB _____

ANALYST Graeser/Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
	Unknown, Likely Negative	Unknown, Likely Negative	Unknown, Likely Negative	Unknown, Likely Negative	Recurring	General Fund
	Unknown, Likely Negative	Unknown, Likely Negative	Unknown, Likely Negative	Unknown, Likely Negative	Recurring	Valencia County

Parenthesis () indicate revenue decreases

*Note: these impacts are partly in relation to possible revenues after a recent Administrative Hearing Office decision; a significant portion of this part of the revenue impact might not have been received historically and would not be included in the latest revenue estimate

Relates to HB245, SB215

SOURCES OF INFORMATION

LFC Files

SUMMARY

Synopsis of Bill

The House Rules and Order of Business Committee substitute for House Bill 324 creates gross receipts tax and compensating tax deductions for a large data center. The bill also proposes a property tax abatement for a large data center. Economic Development Department (EDD) is required to certify the eligibility for a data center non-taxable transaction certificate (NTTC). An eligible data center is an existing data center or a new data center for which the taxpayer and one or more other taxpayers expend \$25 million in eligible costs. The taxpayer claiming the deduction must separately report the deduction to the Taxation & Revenue Department (TRD). TRD is required to report the amount of deduction annually to the legislature. EDD and TRD are required to protect from public disclosure the proprietary business information contained in an application for a data center deduction certificate of eligibility. If, after EDD certifies a data center and the taxpayer begins taking deductions, the taxpayer fails to meet the \$25 million in eligible cost requirement, the bill provides for full or partial clawback.

The effective date of this bill is July 1, 2018.

The property tax abatement phases down over time (100 percent for the first 15 years, 67 percent for the 16th year, 33 percent for the 17th year and no abatement thereafter). There is no delayed repeal date but LFC recommends adding one.

FISCAL IMPLICATIONS

The bill might not significantly decrease state or local revenues below the levels already anticipated with current datacenters in the state, but the bill could prevent future revenues the state and local governments would otherwise receive. The bill expands the limits of what would be considered tangible personal property exempt from property taxes and deductible under industrial revenue bonds (IRBs) using current statute and determinations by TRD and the Administrative Hearings Office.

There is a valid case to make that current application of statute with regard to tangible personal property may be narrower than it had been in the past after a recent Administrative Hearing Office decision, and there are bills making their way through the Legislature that address this “cost segregation” issue of separating out tangible personal property more broadly, creating a uniform standard for nonprofits, governments, and IRB recipients alike. This bill appears to exempt certain items that might not be deductible under current or historical cost segregation filings, and this would lead to reduced revenue for the general fund and the local government.

However, if a bill is not enacted that broadly brings statute in line with historic industry interpretations of cost segregation, this bill may be partly viewed as the state living up to promises made by economic developers and others for how the state’s tax code would impact recently constructed (or partly constructed) datacenter facilities. In addition, the limited scope of this bill would likely have a far smaller impact than the broader applications also under consideration, although that also creates different policy implications.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

SIGNIFICANT ISSUES

The bill uses the phrase “colocation tenant,” in numerous places, and provides that if the facility is sold, any deductions or abatements transfer to the new owners or colocation tenants. This may lead to an understanding of why this bill has been introduced.

The Industrial Revenue Bond (IRB) is a mechanism whereby equipment installed in the facility, including computer equipment, servers, cooling equipment, is considered owned by the sponsoring government. Thus, this equipment is eligible for gross receipts and compensating tax deductions for sale of tangible personal property to a government. Similarly, the government ownership of the facility, including the tangible personal property located within the facility creates a property tax exemption for as long as the government property is property tax exempt.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose. The confidentiality provisions during the certificate application and approval process is somewhat unusual, but once the certificate has been approved and the taxpayer begins claiming the deductions, there is unusually extensive disclosure.

ADMINISTRATIVE IMPLICATIONS

The provisions of the bill impact moderately on the Economic Development Department, but it is expected that at most one or two \$25 million data center investments would be approved annually. TRD would also expend moderate effort in including the clawback provisions in their procedures.

TECHNICAL ISSUES

1. The definitions in this bill are couched in general terms, but, practically, are restricted to expansions of the Facebook Los Lunas site. Article IV, Section 24 reads as follows:
The legislature shall not pass local or special laws in any of the following cases: ... the assessment or collection of taxes or extending the time of collection thereof; ...

This bill may violate this section both as “special” and as “local” laws. In particular, the specificity of the definition of “existing data center” in Section 1 L of the bill is of concern.

2. The legislature is not permitted to enact exemptions or abatements of property tax without constitutional authority. Article VIII, Section 3 [Tax-exempt property] provides as follows:
The property of the United States, the state and all counties, towns, cities and school districts and other municipal corporations, public libraries, community ditches and all laterals thereof, all church property not used for commercial purposes, all property used for educational or charitable purposes, all cemeteries not used or held for private or corporate profit and all bonds of the state of New Mexico, and of the counties, municipalities and districts thereof shall be exempt from taxation.

...

Exemptions of ***personal property*** from ad valorem taxation may be provided by law if approved by a three-fourths majority vote of all the members elected to each house of the legislature. (emphasis added).

And in the case law notes, entitled “Authority of legislature” — The legislature is authorized to exempt certain property from taxation and none other. *Dillard v. New Mexico State Tax Comm'n*, 1948-NMSC-069, 53 N.M. 12, 201 P.2d 345.

It can certainly be argued that this standalone property tax abatement is unconstitutional if the successor “collocated tenant” has not been granted an IRB. Again the theory of the IRB is that the equipment and building subject to the IRB is owned by the sponsoring government for the period of time that the IRB is in effect.

3. The bill changes the rule as to what is real property and what is tangible personal property. In general, the rule is that if tangible personal property is permanently mounted or affixed to real property, it becomes real property. Section 1, Subsection L of the bill provides "... means purchased or leased, tangible or intangible equipment or software, whether affixed to or incorporated into real property..." This issue was debated and probably litigated years ago when an electronics component manufacturer claimed and was granted approval of a vibration-isolation subfloor and all of the air handling equipment needed for a clean room. Both of these nominally real property installations were held to be tangible property for the purpose of the IRB tangible property deduction. The language of this bill is attempting to push the envelope of the general principle.

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

OTHER SUBSTANTIVE ISSUES

The proposed gross receipts and compensating tax deductions for a data center is reminiscent of the exemption for 1-800 or WATS phone service. (7-9C-6 NMSA 1978). This deduction, enacted in 1993, created the call center industry in New Mexico. No one has ever done an economic benefits analysis, but this could be the exemplar for why states enact economic development tax expenditures. When they work, the economic benefits return more revenue to state and local governments than the direct revenue foregone. It could be that this data center deduction could similarly create an entire industry in the state but that is impossible to determine with available data.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy:** Revenue should be adequate to fund needed government services.
2. **Efficiency:** Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity:** Different taxpayers should be treated fairly.
4. **Simplicity:** Collection should be simple and easily understood.
5. **Accountability:** Preferences should be easy to monitor and evaluate

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted:** The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted:** The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent:** The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable:** The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective:** The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions “but for” the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.